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November 1979

THE U.S. BUSINESS OUTLOOK

Although some economic indicators pointed upward in the third quarter of 1979 and raised questions as to whether the much-heralded recession will in fact occur, our view is that indeed it will.

More specifically, we expect real gross national product to decline next year by 1½%, with the first half bearing the brunt. The reason for this outlook, in broad terms, is twofold: Shortrun cyclical excesses--such as huge debt-driven consumer spending--will undergo correction next year; and in addition, America's longrun energy and inflation problem will continue to throttle economic growth.

On the inflation front, we expect that despite the 1980 slowdown, prices will rise by 9% next year, uncomfortably high especially in the face of expected increases in the unemployment rate.

This high inflation-high unemployment situation will create a policy dilemma for the Administration, adding to the political uncertainty of an election year. The Administration and Congress would break the precedents of the post-Depression era were they not to tilt towards fiscal stimulation, again fueling the inflationary fire. Some tax cut is almost certain. At issue is its size.

The Long-Term Problems

For almost a decade, the U.S. economy has been afflicted by two related diseases--high and rising energy costs, and inflation. And regardless of the cyclical adjustments which must take place next year, this twin fever will continue to weaken the economy in 1980.

One of the most serious consequences of the energy and inflation problem is that it has increased uncertainty among business decision makers. In a higher-risk environment, firms and investors have trouble predicting future states of the economy and they therefore tend to take the safe, conservative route: They restrain commitments to the future and concentrate on shortrun stratagems. One result is slower growth, as for example when firms skew their budgets away from capital spending.

In addition to increasing the riskiness of longterm commitments, high and rising energy costs and inflation together have

- increased instability in international currency markets, raising the costs of doing business internationally,
- depressed consumer confidence, and
- raised the cost of domestic capital.

Briefly, energy and inflation have contributed heavily to gyrations in international money markets. And resulting doubts about the relative values of currencies have made it more difficult to gauge the costs and revenues of business endeavors. Consumers, for their part, have been quick to learn that in inflationary times buying sooner rather than later pays off and that borrowed money is relatively cheap. Thus, they've stepped up purchases by chopping two percentage points off their savings rate of the early 1970's and by going into debt. Finally, inflation hikes the cost of domestic capital by increasing risk,

which means higher interest rates and lower price/earnings ratios. Thus, the external financing costs facing firms rises, raising the opportunity cost of internal funds.

Cyclical Excesses

From 1976 to 1978 the amount of consumer installment credit rocketed by nearly 50% to $298 billion. Meanwhile, less and less of the debt was being paid off, so that the net change in outstanding credit more than doubled during the period. In 1979, the consumer continued to pile up big debts. And, compared to disposable personal income, households' net increase in liabilities jumped from 8% in 1976 to 11% in 1978.

From 1976 to 1978 consumers also reduced the relative proportion of income saved, the rate falling from 5.8% in 1976 to 4.9% in 1978. The saving rate rose somewhat during the first half of 1979, but in the third quarter it plummeted to 4.1%. Moreover, real disposable personal income dropped by 0.6% at an annual rate from the first to the third quarter.

Putting the runup in debt and the rundown in savings together points to the conclusion that consumer spending at 1979 levels is unsustainable. In addition, if the Federal Reserve Board sticks to its credit tightening policy consumers will be forced to reduce their borrowing whether or not they consider their balance sheets out of whack. With consumption comprising about two-thirds of gross national product, it's evident that the correction will have a large impact on the economy next year.

In addition, the super-high interest rates caused by the Fed policy will particularly hit the housing sector as mortgage rates jump and thrift institutions

lose funds via disintermediation. House buying will also be damped by consumer debt load correction.

While the immediate purposes of the Fed action were to shore up the dollar and tighten credit, the longer term hope is that the upward spiral of inflationary expectations can be broken. To state it another way, the Fed action can be viewed as an attempt to correct the cyclical excess of money creation, an excess which has created the inflationary expectations which in turn feed into more rush buying and yet higher prices.

Money growth accelerated sharply in 1976 and then moderated or fell over the next two years, depending on what measures of the money stock you look at. But, taking M1 as an example, even this moderation produced money growth of 7%-8%, twice the rate of growth in the period just prior to U.S. involvement in Vietnam. Money growth rates then declined during the first part of 1979, but shot up again in the second half of the year.

In this context, and with inflation running at more than a 13% annual rate and the dollar under fire, the Fed made its move. We assume the Fed will stick to its guns through the first half of 1980, so that higher interest rates and tighter credit will restrain economic activity. As election time approaches and recession visibly impacts the economy, however, pressure will mount for the Fed to loosen its grip on the money supply.

The Fed policy will at the same time have an impact on employment, which will be particularly vulnerable in 1980 because during the recent expansion jobs were created at an extraordinary rate. In fact, in strictly economic terms, it could be said that job creation was excessive, in the sense that firms chose to increase output by increasing manpower rather than by adding plants and equipment.

From 1974 to 1978, real growth in GNP was nearly 15%, nonagricultural employment grew by 9½%, and real spending on plants and equipment grew not at all. According to our 26th Annual Preliminary Survey of U.S. Business' Plans for New Plants and Equipment, firms plan about a 7% increase in real capital spending in 1979, but next year they expect no real gains in capital expenditures. Meanwhile, the rate of job creation has slowed this year compared to the previous three years, and we expect employment to suffer next year as firms faced with soft demand correct their "excess" job creation.

We also expect that firms next year will have to do some correcting of excessive inventories. The reason is that business typically enters a downturn in an overly optimistic frame of mind, and consequently gears up for sales which don't materialize. As an example of this phenomenon, McGraw-Hill's Fall capital spending survey reports that while manufacturers expect recession or slow growth in 1980 (say, 1% real growth at best), at the same time they expect their real sales to grow by 3%.

It is expected, too, that some capital projects will be abandoned or pared down next year as the recession unfolds.

With the consumption and investment sectors providing no strength next year, is there any hope for help from net exports?

The fall in the value of the dollar should improve the price competitiveness of U.S. exports, and a weakened economy next year should damp the demand for imports. Thus, on the face of it, there should be some improvement in the U.S. balance of trade. However, with OPEC apparently bent on sending oil prices further into the stratosphere, the U.S. oil bill--comprising about one-fourth of total import expenditures--will jump again. Thus, we will witness another scene in the longrunning drama of how the U.S. transfers income abroad.

If the above assumptions are correct, unemployment will be rising and activity will be falling as the economy moves through the first half of 1980. Add the fact that 1980 is an election year, and government action looks very likely. We expect that Congress will enact a tax cut to spur the economy, and that the Fed will give in to pressure to ease up on interest rates and the money supply. These policies will provide a shortrun uptick to growth, but will also contribute, with a lag, to inflation.

Summary

Overspending by consumers, overemploying by business, and other economic excesses are coming to a head and are due for a correction. That correction is expected to have its major impact on the first half of 1980, sending the annualized rate of growth to -5.1% in the first quarter and -3.4% in the second quarter.

Meanwhile, continuing energy and inflation problems will restrain the economy next year, and will help damp recovery in the second half. Energy and inflation problems, furthermore, are expected to persist over the foreseeable future. On the inflation side, one major element in 1980 will be wages catching up with inflation. Energy, too, will of course be an inflationary factor next year, as OPEC's hand is strengthened by the uncertainty of oil supplies from Iran. Possible supply shortfalls will also place additional restraint on economic activity in the U.S. The risks, then, are skewed toward the downside next year.

Short term, therefore, the outlook is for negative growth followed by a sluggish rebound in 1980, accompanied by rising prices and unemployment. Longer term, our view is that inflation and energy will continue to be the key stumbling blocks of the economy. The implication is that this twin onus will prevent the economy from entering a period of strong growth.

NATIONAL PRODUCT ACCOUNTS AND KEY ECONOMIC INDICATORS
(Billions of Dollars)

	Actual 1979 2Q	Actual 1979 3Q	Forecast 1979 4Q	Forecast 1980 1Q	Forecast 1980 2Q	Forecast 1980 3Q	Annual 1977	Annual 1978	Annual 1979
National Product Accounts									
Gross National Product	2329.8	2395.4	2434.3	2453.5	2483.7	2543.7	1899.5	2127.6	2362.9
Consumer Spending	1475.9	1527.7	1558.0	1580.0	1606.9	1652.8	1210.0	1350.8	1504.0
Gross Private Domestic Invesment	395.4	393.7	388.8	379.5	372.4	377.0	303.3	351.5	388.0
Fixed Investment	361.9	378.4	381.0	379.5	373.4	376.0	281.3	329.1	369.5
Nonresidential	249.1	262.0	266.0	268.0	266.7	268.0	189.4	221.1	255.8
Residential	112.9	116.4	115.0	111.5	106.7	108.0	91.9	108.0	113.9
Inventory Change	33.4	15.3	7.8	0.0	-1.0	1.0	21.9	22.3	19.4
Government Purchases	466.6	477.5	490.5	497.0	506.9	516.6	396.2	435.6	473.7
Federal	161.7	162.7	168.5	169.5	173.0	176.4	144.4	152.6	164.1
State & Local	304.9	314.8	322.0	327.5	333.9	340.2	251.8	283.0	309.6
Net Exports	-8.1	-3.5	-3.0	-1.5	0.0	0.5	-9.9	-10.3	-2.7
Real GNP (1972 dollars)	1422.3	1434.4	1426.0	1407.5	1395.6	1400.2	1340.5	1399.2	1428.3
(% change annual rates)	-2.3	3.5	-2.3	-5.1	-3.4	1.3	5.3	4.4	2.1
Implicit Price Deflator (% change annual rates)	9.3	8.0	9.2	9.0	8.8	8.7	6.0	7.3	8.8
Key Economic Indicators									
Unemployment Rate (percent)	5.7	5.8	6.2	7.2	7.8	7.9	7.0	6.0	5.9
Housing Starts (thousands of units)	1834	1825	1730	1525	1460	1500	1987	2020	1751
Consumer Price Index (% change annual rates)	13.6	12.9	12.8	10.5	9.5	9.5	6.5	7.7	11.2

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February 1980

THE U. S. BUSINESS OUTLOOK

A FUNNY thing happened on the way to the recession...the consumers forgot to come along.

In fact, they decided to go the other way: In last year's fourth quarter consumers increased their purchases by more than 4% (on an annual basis), after inflation is stripped away. With inflation added in, consumption expenditures soared by more than 14%.

This continuation of the consumer spending spree was enough to cause inflation-adjusted (real) growth in 1979's fourth quarter of 1.4%--thereby confounding nearly all forecasters, who expected a decline in gross national product in the fourth quarter. What we forecasters did not foresee was the continuing---some might say astonishing---fall in the rate at which people save. That rate was down to 3.3% in the fourth quarter, half the average for the decade. Thus, even though their real income stayed flat, people were able to increase spending.

The key question then for the 1980 outlook is: Will the consumer quit?

The Consumer Conundrum

It's obvious the economy cannot keep growing by forever getting

injections of spending via reduced savings rates. True, the savings rate may stay depressed below historical norms for a long time because consumers--by now highly seasoned veterans of the 1970s' inflation wars--will be scrambling to cope with rising prices by buying sooner rather than later.

Also, the economy might be in for an extended period of low savings rates due to the shifting age structure of the population. The baby boom of the 1940s and '50s has become the young adult and middle age boom of the 1970s and '80s. And people in their twenties and thirties tend to borrow more and save less than other age groups as they begin families, buy homes, and otherwise accumulate an initial stock of possessions.

But even after acknowledging these developments, it must be noted that with the savings rate at 3.3%, there is just not much more room for it to fall. And that means further boosts to consumer spending will have to come from gains in disposable personal income or from increased borrowing.

Several things argue against a further burrowing into debt: One, the sharp rise in housing prices may be over, which means people will have less incentive to borrow on the increasing equity portions of their mortgages. Two, heavy recent borrowing at high interest rates implies high interest payments, which will reduce people's ability to take on new debt. Three, continued tight monetary policy would simply reduce the pool of loanable funds available to consumers.

Although it can't be said the above have already started to work, there is a little evidence that consumers have reined in their propensity for debt. The evidence is that the ratio of net change in installment debt to disposable personal income has declined by one half from the September peak of 3.2%.

As for disposable income, there is no reason to expect real gains in

the short term, unless consumers continue to rev up the economy by saving less and spending more. But as argued above, continued increases in spending would require pulling a rabbit out of a hat. And even if possible for a quarter or two, there are only so many rabbits a hat can hold. The scenario foreseen here is that final demand will be shrinking in the near term due to consumers' attempt to adjust their debt-laden balance sheets, and that this in turn will reduce employment, resulting in a fall in inflation-adjusted personal income.

In what way will the consumer cut back? Interestingly, consumers have already been backing away from purchases of durables. In fact, consumer durables have been going through their own separate recession, with real purchases in last year's fourth quarter down nearly 3% from the first quarter (nearly 4% annually). Durables purchases also fell in the fourth quarter compared to the third. This pattern of durables purchases is typical of a recession in the overall economy, yet the economy has continued to grow.

The driving force in consumer spending has been in nondurables, which grew by a smart 8% (annual rate) in real terms in the fourth quarter. Within nondurables, the growth has come mainly in clothing and shoes.

There are two messages contained in this mix of consumer spending. One is that since consumers have not been stocking up heavily on consumer durables, it's not expected they will suddenly stop buying them. That is, once people buy a durable good, they don't have to buy that type of good for some time; so if a lot of people were stocking up on such goods in a given year, sales in the following year would likely be very weak. However, since durables sales were sluggish in 1979, we don't expect a collapse in demand in 1980.

The second message is that nondurables spending should also weaken,

in part because of the recent large expenditures on clothing and shoes. Note that while clothing and shoes are categorized as nondurables, they share a characteristic of durable goods--they are not consumed immediately, but rather they render services over time. As a consequence, large purchases in recent quarters imply a cutback in the near term. Again, however, the slowdown should be moderate. All told, we hardly expect a debacle in consumer spending, although we do expect the physical volume of consumer goods purchased to decline this year.

Other Sectors: Less Puzzling But No Stronger

With consumption weak in 1980 will the economy get a boost from some other sector? Unfortunately, probably not.

Capital spending in 1979's fourth quarter fell in real terms relative to the third quarter. That fall, however, was in part due to strikes in the agricultural machinery and electrical machinery industries. These strikes have been settled, and as a consequence we expect capital spending in 1980's first quarter to contain a catchup element.

Moreover, since the main determinant of capital spending is the recent performance of the economy, and since the economy registered positive real growth in the second half of 1979, we expect some modest near-term buoyancy in plant and equipment spending. After rebounding in the first quarter of 1980, however, capital spending should show little strength until yearend.

In fact, key leading indicators of capital spending--new orders for nondefense capital goods and construction contracts--suggest some weakness. The nominal value of new orders has been steady in the past few quarters, which implies a decline in the physical volume of capital goods ordered. Similarly, F. W. Dodge data shows that construction contracts for commercial and industrial square footage flattened out in mid-1979, after a strong first

quarter.

More recently, contracts have picked up somewhat, implying that actual expenditures on business structures will come later in 1980. Capital spending will also be getting a boost in the latter part of 1980 as industry gears up for increased defense spending.

All in all, real business fixed investment should be down in 1980 by about 1%.

Inventory investment, meanwhile, should probably not have a sharp impact on gross national product this year, which is a good thing. The reason is that in a typical recession inventories pile up as business miscalculates final demand; then, once the recession is recognized, inventories are rapidly pared down, thereby reducing GNP and imparting volatility to the economy.

This time around, however, business has been keeping inventories in line with sales, so that sharp decumulations should not be necessary, even as sales fade.

The anticipated squeeze on housing arrived last quarter, when starts averaged about 1.6 million at an annual rate, down from more than 1.8 million in the previous quarter. The reduction in housing starts will be reflected in GNP next quarter, by way of residential investment.

Housing is expected to flounder even more as it continues to get buffeted by high mortgage rates and low mortgage availability. However, as interest rates fall due to a softening economy, mortgage rates will come down also, probably by midyear. Concurrently, lower interest rates (by damping disintermediation) and a higher savings rate should be pulling and pushing increased savings flows into thrift institutions. The result: a revitalized housing industry.

Meanwhile, though, consumers have been saving little. And due to the low legally mandated rates paid on savings accounts, they have no incentive to put what they do save into the thrifts. Consequently, net new savings received by savings and loan associations have been on the wain. During December, in fact, inflows were a negative $734 million, evidence that the mortgage market will be tightening further.

The rapidly evolving world political/military situation is obviously going to be a key factor in determining government spending this year. President Carter has asked for a 12% hike in defense spending for the year beginning October 1, but it is likely that current events in a volatile world will be steering the hands of both the President and Congress in 1980.

Further uncertainty on the government spending questions comes on the political/economic side: How much will the Administration try to stimulate a soft economy as election time--or perhaps nomination time--approaches? As we said in our last Outlook, we expect a tax cut later this year, although the size may be moderate in the face of increased defense spending and high inflation.

The net export account this year will be heavily influenced by two things: petroleum and the dollar. Oil-producing countries announced stiff price increases in December followed by further increases in January, and these actions will quickly show up on the U.S. trade balance. Partially offsetting the oil price hike will be continued strength in U.S. exports, which are being boosted by a fallen dollar. But the offset won't be nearly enough to get U.S. net exports back into the plus category.

For the year as a whole, then, we see small negative growth. But despite this sluggishness, there is not much hope for significant improvement

on the inflation front.

Inflation: The Beat Goes On

As already noted, oil-producing countries have been raising prices once again, which has obvious implications for inflation.

Another reason to expect inflation to stay high is that wages last year rose nowhere near as fast as did the consumer price index. And even though this index overstates inflation in periods when house prices and mortgage rates are rising, the consumer price index is the measure of inflation to which labor pays most attention. Consequently, 1980 should see workers playing wage catchup, with companies passing through their increased labor costs.

So even though the rise in house prices and financing costs are expected to moderate in the first half of 1980, inflation (measured by the consumer price index) will still likely remain in the double-digit area.

Towards midyear, the economy should be weak enough to pull inflation down a bit, but the country would be lucky if the rate of change in the consumer price index gets below the double-digit range. Neither is the longer-term outlook on inflation good, especially in the post-Afghanistan era of increased government spending. If this Administration or the next insists on both big guns and creamy butter (a la Lyndon Johnson), the groundwork would be laid for another surge in inflation, or for a round of tax boosts. And a tax boost, ironically, would add to the inflation tax already being levied on wage earners who have been pushed into higher tax brackets unadjusted for inflation.

McGraw-Hill Publications Company
Department of Economics

February 1980

NATIONAL PRODUCT ACCOUNTS AND KEY ECONOMIC INDICATORS
(Billions of Dollars)

	Actual 1979		Forecast 1980				Annual		
	3Q	4Q	1Q	2	3Q	4Q	1978	1979	1980
National Product Accounts									
Gross National Product	2396.5	2455.8	2509	2546	2590	2647	2127.6	2368.0	2573.0
Consumer Spending	1528.6	1580.4	1621	1646	1679	1714	1350.8	1509.8	1665.0
Gross Private Domestic Investment	392.3	383.3	388	391	391	401	351.5	386.2	392.9
Fixed Investment	377.8	376.9	382	376	379	391	329.1	367.8	382.1
Nonresidential	261.8	261.3	271	273	275	278	221.1	253.9	274.3
Residential	116.0	115.6	111	103	104	113	108.0	113.9	107.8
Inventory Change	14.5	6.4	6	15	12	10	22.3	16.4	10.8
Government Purchases	477.8	499.8	513	521	530	542	435.6	476.1	526.5
Federal	162.9	177.0	183	186	189	194	152.6	166.3	188.0
State & Local	314.9	322.8	330	335	341	348	283.0	309.8	338.5
Net Exports	-2.3	-7.7	-13	-12	-10	-10	-10.3	-3.5	-11.3
Real GNP (1972 dollars)	1433.3	1438.4	1437.2	1427.0	1420.2	1421.0	1399.2	1431.1	1426.4
(% change at annual rates)	3.1	1.4	-0.3	-2.8	-1.9	0.2	4.4	2.3	-0.3
Implicit Price Deflator									
(% change at annual rates)	8.5	8.7	9.3	9.1	9.0	9.0	7.3	8.8	9.0
Key Economic Indicators									
Unemployment Rate (present)	5.8	5.9	6.3	6.7	7.0	7.1	6.0	5.8	6.8
Housing Starts (thousands of units)	1834	1604	1460	1425	1525	1675	2007	1722	1521.0
Consumer Price Index									
(% change at annual rate)	12.9	13.3	13.5	11.5	10.4	10.0	7.7	11.2	12.4

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May, 1980

THE U.S. BUSINESS OUTLOOK

THE STORM clouds gathering for so long on the economic horizon are finally over head. In April, for example, the following signs of recession came showering down:

- Retail sales--off more than 1% from March (down more than 13% at an annual rate).
- Employment--a half million jobs lost between March and April.
- Production--factory output slashed by 1.9% (21% annualized).
- Housing--starts down by 2.1% from the already depressed March level, and 42% below the year-ago figure.

The economy, moreover, is due for a further dampening: Consumers, who propped up the economy last year by borrowing lots and saving little, will cut spending significantly; retail sales will thus continue to fall, leading to a reduction in orders. Looking at lightweight order books, manufacturers will further cut production and lay off more workers; as employment falls, income will fall, causing further cutbacks in consumer spending.

The driving force behind this scenario is a drop in personal consumption expenditures. Therefore, the key

question is: Why should consumers stop behaving as they did last year when they defied economists' logic and kept up a spending spree they really couldn't afford?

Beyond the answer to this question is another question: Once consumers cut back their purchases, and production and employment slumps, why should things stop getting worse and start getting better? In other words, why should the economy recover? The answer to this question will be tackled later. But first, why the recession?

The Consumer Quits At Last

Jolted by the Federal Reserve Board's mid-March credit crackdown, consumers began to think twice about whipping out their credit cards and running up further--now more expensive--debt. The result: The net increase in installment debt in March ($1.4 billion) was well below February's figure ($2.3 billion), and off sharply from March a year ago ($3.6 billion). Consumers' newfound conservatism on credit is expected to continue until they feel liquid enough to handle bigger debt loads.

Besides losing their taste for debt-financed purchases, consumer appetites will also be checked by the big payments they'll be making on previous loans. At the same time, consumers are expected to start worrying about their neglected savings, which last year were sacrificed in the interest of consumption. (The savings rate--savings as a percent of disposable personal income--tumbled to 3.5% in last year's

fourth quarter, the lowest it has been in three decades.) The savings rate rose during the 1969-70 recession and trickled down slightly in the 1973-75 recession. Even at its low point in the last recession, however, it was 6.4%, well above the current rate.

If consumers begin saving at a more normal rate, it means of course that less of their income will be available for purchases. And, in fact, in recent months consumers have started to save more: From 3.4% in December, the savings rate inched up to 3.5% in January; it then jumped to 3.7% in February and 4.0% in March. The bite into retail sales, consequently, may be deep.

However, more important than increased debt payments and higher savings rates as a deterrent to consumer spending will be a drop in income, caused by a reduction in employment. True, most people will continue to work right through the recession. But for the economy as a whole, income will not be as high as it would have been with higher levels of employment; and when inflation is taken into account, personal income for the economy as a whole will be falling. Moreover, recession will put a damper on wage increases for those still working. Thus, a disappointingly slow rise in wages may depress spending, as workers decide to wait for better times before parting with cash in hand. Similarly, the publicity which will be given to unemployment may spur some employed workers to save more as a hedge against loss of their own jobs.

In sum, inflation-adjusted personal consumption expenditures are likely to fall steeply this year, especially in the current quarter. With such expenditures accounting for about two-thirds of gross national product (GNP), it is easy to see that a weak consumer means a weak economy.

Housing Bottoms Out

The consumer has just recently begun to retrench. Housing meanwhile has been in the trenches since late last year, suffering heavy casualties.

In April, new houses were being started at an annual rate of just over 1 million, a near 50% plunge from last September's rate. Moreover, starts are forecast to fall further to a 950,000 annual rate in the second quarter, 68% off the first quarter level (at an annual rate).

As a consequence, residential investment (the entry in the GNP accounts) has begun to fall and will continue to drop precipitously, reflecting (with a lag) the collapse in housing starts.

But in contrast to consumer spending, the housing debacle may soon be coming to an end. Mortgage rates, after all, have taken a substantial tumble, bringing monthly mortgage payments within the reach of more people. House prices, too, have been declining: The median price

of a house in February was $65,000; in March it was $63,800.

Lower house prices and lower mortgage rates in and of themselves should stimulate the home ownership urge of many, especially those who have felt shut out of the market by high prospective financing costs.

The decline in mortgage rates, of course, reflects the decline in interest rates generally. And this general decline implies that builders will again start thinking about taking out construction loans. So the housing market should soon be reviving on both the demand and supply sides.

At the same time, the revival may not be dramatic in the near term: Depressed housing markets have resulted in a large overhang of unsold units on the market--10.6 months' worth in March at current sales rates; and not until this stock of homes is whittled down will builders feel strong incentives to put up a flock of new dwellings. Also, budget-conscious consumers in the midst of a recession may decide to delay house purchases until the economic outlook is a little brighter.

Nonetheless, housing is getting set for a rebound.

Capital Spending Tops Out

While consumers have spent themselves out and while housing still has a lot of holes in its roof, there is one sector expected to show strength in the very near term--capital spending.

Typically, as the economy enters a downturn, business expenditure on plant and equipment continues to hold up. For one thing, capital budgets drawn up for the following year tend to reflect the strength or weakness of the economy in the period prior to budget making. Thus, 1980 capital budgets would reflect events in 1979, when continued economic growth may have made firms optimistic about the future.

Optimism may also have been fueled by healthy corporate cash flow--up 6.2% in 1979, after taking out inflation. Since cash flow is an important source of capital project financing, firms may have felt that obtaining sufficient funds for 1980 projects would not present a problem.

In line with this relatively upbeat perspective, nonresidential fixed investment grew faster than the rest of the economy in 1980's first quarter, and is expected to outpace the rest of the economy in the second quarter too. For the year, McGraw-Hill's annual spring survey found that business plans to raise capital expenditures by 12.2%.

However, while capital spending will stay up relative to other sectors in the short run, it will soon react to the weakening of the economy; and as a result, plant and equipment expenditure will turn down later in the year.

Thus, the survey figure of a 12.2% gain seems too high because it reflects the relatively optimistic plans in effect as of the beginning of 1980--plans, that is, not yet adjusted for changes in the economic outlook.

Given the downturn, nonresidential fixed investment is likely to rise this year by about 9½%. With inflation about matching this gain, however, real capital spending in 1980 will at most equal 1979 expenditures.

Looking beyond 1980, capital spending will likely be weak in the first half of 1981, for reasons parallel to those explaining the relative strength in early 1980: Spending plans lag economic events, so the weak 1980 economy will dampen spending in the early part of the 1981 recovery.

The Dynamics of Recovery

All told, real GNP is expected to slump by 3% from the peak of this business cycle (1980's first quarter) to the trough (1981's first quarter). That compares to a 5.9% peak-to-trough plunge in 1973-75 and a 1.1% fall in 1969-70. The 1980 recession, by this yardstick, is thus expected to be moderately severe.

As the economy moves through recession, however, and as rising unemployment sparks dire warnings of Depression in newspapers and magazines, the recession may seem severe

indeed. So severe, in fact, that the possibility of a 1981 turnaround may appear slim. Why, then, should the economy perk up in the first part of 1981?

One boost to economic activity could come by way of government--either increased spending or a tax cut or a combination of both. As election time approaches, some stimulus is to be expected.

However, even if politicians stick to their new-time religion of fiscal conservatism, the economy will still turn the corner in 1981.

First in line on the recovery list will be the housing industry. As discussed above, cautious home seekers will be lured into the market by declining mortgage rates and house prices. As sales pick up and the inventory of unsold homes is pared down, builders will increase their activity, while at the same time they will be able to get lower-cost construction loans.

A rise in residential building is important to recovery in and of itself because the industry employs so many people (about 700,000 at the end of last year). But in addition, increased house and apartment construction gives rise to demand for home-related products like furniture, rugs, and appliances. Demand for these products, in turn spurs demand by their manufacturers for basic materials--lumber,

textiles, steel. These latter industries then increase production and hire more people, which leads to increased incomes. The circuit then continues to the retailers, who experience a rise in sales and who consequently place more orders and hire more people.

Thus, the entire economy will get a lift from the housing industry's revival.

As a share of GNP, however, residential construction is only about 5%--hardly an insignificant number, but not big enough to handle the job of turning the economy around all by itself. Moreover, the other fixed investment sector--nonresidential--will be slumping at the end of 1980 and beginning of 1981; and since nonresidential investment is much greater than residential, the net contribution of fixed investment to recovery will be small.

More crucial to recovery than housing will be consumer spending, which accounts for two-thirds of GNP. Consumer spending will, of course, be stimulated by improvements in the housing market, as described above. But other forces will also be at work.

In the near term, consumers are expected to tighten their belts in order to pay off debts and accumulate savings, thereby bringing on a recession. The corollary is that once consumers feel liquid again--once, that is, they can stop worrying about how to pay the bills due tomorrow--they

can begin thinking again about making purchases. In particular, they can think about buying expensive items--like autos--which were the first things cut from consumer budgets. A pickup in consumer purchases of durable goods, then, should be a key element in the 1981 economic turnaround.

Once consumer spending starts to rise, the whole chain of events leading to increased employment and incomes proceeds, with increases in incomes boosting consumption even further.

Besides feeling ready to take on more debt in 1981 (due to improved liquidity), consumers will also be induced to borrow by relatively low interest rates. Interest rates have already fallen sharply since mid-April and are likely to fall further for at least two reasons: One, the Federal Reserve Board has begun to ease its credit restrictions and will probably ease them further. Two, as the recession wears on, business loan demand will lessen as capital projects are delayed and inventories are reduced in line with sales. If the Fed decides to loosen its grip on the money supply, interest rates could fall even further.

In 1981, then, the stage will be set for consumer belt loosening.

Summary

After being buoyed up for so long by continued consumer spending, the economy fell into recession with a thud in the second quarter of 1980. Several more quarters of negative economic growth will follow, as consumers try to reduce debt and increase savings, and as business curtails capital spending.

Meanwhile, the drop in mortgage rates and house prices will be setting the stage for a recovery in residential construction. Increased house building will spur employment and income, which in turn will stimulate retail sales and the economy in general.

Somewhat later, but with more power, consumers will begin loosening their pursestrings and seeking more credit. The reason: Savings will be deemed sufficient, interest rates will be declining, and monthly credit payments on old debt will no longer be prompting domestic crises. In short, consumers will have regained confidence, and the economy will consequently resume positive real growth.

McGraw-Hill Publications Company
Department of Economics

May, 1980

NATIONAL PRODUCT ACCOUNTS AND KEY ECONOMIC INDICATORS
(Billions of Dollars)

	Actual	Forecast					Annual	
	1980	1980			1981			
	1Q	2Q	3Q	4Q	1Q	2Q	1979	1980
National Product Accounts								
Gross National Product	2516.1	2537.0	2569.0	2619.0	2675.0	2758.0	2368.8	2560.3
Consumer Spending	1628.7	1635.0	1665.0	1700.0	1742.0	1801.0	1509.8	1657.2
Gross Private Domestic Investment								
Fixed Investment	384.0	386.0	376.0	374.0	377.0	392.0	387.2	380.0
Nonresidential	273.3	279.0	281.0	282.0	283.0	284.0	254.9	278.8
Residential	110.5	92.0	82.0	85.0	91.0	101.0	114.1	92.4
Inventory Change	0.1	15.0	13.0	7.0	3.0	7.0	18.2	8.8
Government Purchases	517.4	528.0	538.0	554.0	565.0	577.0	476.4	534.4
Federal	186.2	191.0	195.0	205.0	210.0	215.0	166.6	194.3
State & Local	331.2	337.0	343.0	349.0	355.0	362.0	309.8	340.1
Net Exports	- 14.0	- 12.0	- 10.0	- 9.0	- 9.0	- 12.0	- 4.6	- 11.3
Real GNP (1972 dollars)	1442.6	1420.5	1405.4	1399.8	1397.6	1409.3	1431.6	1417.1
(% change at annual rate)	0.6	- 6.0	- 4.2	- 1.6	- 0.6	3.4	2.3	- 1.0
Implicit Price Deflator								
(% change at annual rate)	9.3	10.0	9.8	9.7	9.5	9.3	8.8	9.3
Key Economic Indicators								
Unemployment Rate (percent)	6.1	7.5	8.3	8.5	8.6	8.3	5.8	7.6
Housing Starts (thousands of units)	1263	950	1000	1100	1200	1400	1745	1078
Consumer Price Index								
(% change at annual rate)	16.9	13.5	10.2	9.1	8.9	10.5	11.3	13.6

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August, 1980

U.S. BUSINESS OUTLOOK, SHORT-TERM

THE ECONOMY did its bit for the science fiction craze in 1980's second quarter by falling through a black hole in space:

- Inflation-adjusted consumption rocketed down at the near light-speed of 9.4%.
- Zapped by high mortgage rates, housing began to disintegrate. Builders ducked for cover, cutting starts by more than one-half (at an annual rate) from the already depressed first-quarter level.
- Attempting to defend balance sheets against the economic onslaught, business sharply retrenched on capital spending, slashing real investment in plant, equipment, and vehicles by 18% at an annual rate.

Altogether, the April-June period added up--or down--to a tie with the first quarter of 1975 for the worst economic quarter in the post-World War II era: Gross national product (GNP) plunged at an annual rate of 9.1%. What's more, final sales--GNP less inventory change--plummeted at a 9.6% annual rate, worse than any quarter in the severe 1973-75 downturn.

Why So Bad?

Why recession is occurring in 1980 is no big mystery. With inflation building in 1979, lenders demanded higher and higher interest rates to protect against loan repayments in cheapened dollars. (The prime rate hit an historic high of 20% in April.) Sky-high interest rates, in turn, meant that thrift institutions had to pay out more than

usual to attract funds, which in turn meant they had to raise mortgage rates. And every notch up on the mortgage rate scale meant fewer and fewer people could afford new homes. As a consequence, housing demand fell sharply; and down with it went spending on furniture and household equipment.

Meanwhile, inflation was also spurring consumers to buy at a faster and faster pace in an attempt to beat even further price hikes. And since incomes were barely keeping up with prices, people sustained their purchasing power by going heavily into debt and by reducing the amount of income saved. The saving rate dropped to 3.5% in the fourth quarter of 1979, down from 5.4% in last year's second quarter and well below the more than 7% prevailing in the first half of the 1970s; installment credit outstanding grew to more than 15% of personal income in 1979, compared to just over 13% for most of the '70s. As debts mounted, repayment plus interest costs ate an increasingly large hole in peoples' incomes. Conversely, less money was available for new purchases.

At the same time, employment was increasing only slowly in 1979, so that prospects for sizable increases in personal income were dim. Combine free spending with sluggish income growth, rising debt, and falling saving rates, and it is clear that consumers last year and into this year were engaged in a game of make-believe: They could play at pretend-prosperity for some time, but inevitably the game would end and reality would intrude.

The severity with which reality did intrude, however, was a shocker. What caused the unusually steep and unanticipated drop, apparently, was a combination of two things: On their own, consumers developed the feeling that enough was enough--any more debt-financed

spending would be intolerable. Then in addition, the Federal Reserve Board came up with its credit controls program in March. And if nothing else, these controls created enough confusion so that consumers became extra wary of using credit. Hit by the double whammy of credit over-extension and credit controls, while also fearing unemployment (employment began to fall in March), consumers went cold turkey.

Besides the consumer collapse, another surprise in 1980's second quarter was business' sharp cutback in fixed investment. Typically, it takes business a quarter or so to cut capital spending plans once the economy starts to decline, so that in the initial stage of recession business fixed investment can cushion the downturn. This time around, investment crashed immediately. Much of the decline, though, was due to reductions in truck and auto purchases. If these categories are taken out, inflation-adjusted investment fell at an 8% rather than an 18% annual rate.

Nevertheless, investment did fall, suggesting that business may be sharpening its informational antennae in order to react with increasing speed to changing economic conditions. Instant-reaction strategy was also evident in business' attempt to pare inventories by slashing production 18% at an annual rate in the second quarter. But due to steep falls in demand, inventories continued to accumulate. For the economy as a whole, inventories increased by nearly $12 billion. And that accumulation could cause trouble as firms continue their efforts to lower inventories in line with sales.

Looking Good, But...

With the economy down so deep in the second quarter, anything that happens subsequently will likely look good. However, while the economy should not suffer another plunge on the order of 9%, it is still headed downward--only at a slower pace. Moreover, the decline may well extend throughout this year. In other words, improvements in economic statistics--e.g., the index of leading indicators rose by 2.5% in June--should not obscure the fact that the economy is still worsening. But given the second-quarter shock treatment, why should any further worsening occur?

One reason, hinted at above, is inventories. The ratio of business inventories to sales climbed to 1.52 in May, up from 1.40 a year ago. Manufacturers' inventories in particular are getting out of line, implying further cutbacks in industrial production and further layoffs. Thus, even though the latest unemployment figure was "encouraging" in that it held steady at 7.8% in July, the rate is bound to rise. Moreover, even though press reports carried the news that employemnt in July rose, that rise was based on the government's survey of households, which economists consider less reliable than a parallel government survey of companies. And the company survey showed that nearly a quarter million jobs disappeared in July. This drop in employment, plus expected further drops, means that personal income in real terms will be weak, and that consumption, likewise, will be weak.

The second major reason why economic activity will continue to decline is that consumer debt loads are still too heavy and savings are still too low to allow people to surge into the stores, credit cards in hand. At the same time, consumers have been making substantial efforts to "reliquefy."

As can be seen in the table below, consumers began saving more of their disposable income in the first quarter of this year (and they are expected to continue to save more). The table also shows that people have been whittling away their debt load since late last year. In fact, in recent months the amount of installment credit outstanding has actually fallen--the first time that's happened since the spring of 1975. But for consumers to get their debt position down closer

The Consumer Seeks Liquidity

		Saving Rate (% of Disposable Income)	Installment Credit (% of Personal Income)
1979	I	5.0%	14.80%
	II	5.4	15.06
	III	4.3	15.07
	IV	3.5	15.04
1980	I	3.7	14.90
	II	4.7	14.58

to an historic norm, additional debt reduction is necessary; and as this reduction takes place, consumers will have to rein in their purchases.

Facing continued weak demand in the near term, business will find little incentive to expand capacity, thus putting a damper on fixed investment. Some "correction" of the extremely soft second quarter results may occur, however, as firms replace more of their auto and truck fleets. One spur to replacement may be a firming of used car prices, which fell in the second quarter. If fleet owners can get better deals on trade-ins, they will be more likely to buy new vehicles.

Residential investment, meanwhile, will remain weak in the third quarter--despite a resurgence of building--because the investment in housing lags behind the construction. Government spending, too, should be relatively weak. Federal government is trying to hold the line on purchases of goods and services, and state and local govenments will be constrained by recession-reduced tax revenues.

In sum, while the economy went through a wringer in the second quarter of 1980, there is more wringing to come. The recession will extend, at least, through the third quarter; and at best, the fourth quarter could show feeble growth. By the first quarter of next year, however, recovery should be underway.

Looking Good, No Buts

The initial stage of recovery will be driven by house building. From April to June, mortgage reates dropped by three percentage points to about 13.5% on average. That may still seem high, but it lead to a surge of house buying in May (sales were up 39% over April) and then to an unexpectedly robust snapback in June housing starts (up 30% over May). Meanwhile, the madian price of a house in the U.S. declined from $64,800 in February to $62,600 in May. At the same time, federally-insured savings and loan associations increased their mortgage commitments in June by 1.5 billion.

All in all, then, everything is in place for a housing comeback. After having fallen from an annual rate of 1.8 million in last year's second quarter to just over a million in 1980's second quarter, housing starts are seen climbing back to more than 1.2 million in the third quarter. By the fourth quarter of 1981, starts are expected to be running at an annual rate of 1.7 million.

Following on the heels of housing in chasing economic activity upward will be purchases of consumer durables. As more houses are bought, it follows that more furniture and appliances will be bought. But in addition, people are expected to buy more autos--even ones made in America.

For U.S. carmakers, the second quarter of 1980 was worse than anything they suffered in the 1973-75 recession; consumers bought only 5.5 million domestically made cars (annual rate), down a third from 1979 sales levels. But even though American cars may have permanently lost a substantial share of market to foreigners, Detroit's OPEC-engineered depression can't last forever. Fueling the pickup in car sales will be improved consumer liquidity, relatively attractive interest rates on car loans, the need to replace cars that should have been traded in months ago, and U.S. manufacturers' introduction of new fuel-efficient models. Some rebound, in fact, has already occurred; in July, sales jumped up to a 6.4 million unit annual rate. By the second quarter of 1981, sales are expected to exceed 7 million units.

Once housing and autos turn around, the recovery will gain momentum. These two key sectors will give employment a boost, in turn leading to a rise in personal income and then to increases in consumer spending. A general rise in economic activity will stimulate increases in business fixed investment, and will also lead to increased revenues and spending by state and local governments.

The second and third quarters of 1981 are thus forecast to show solid growth of 4.6% and 4.8%, respectively. Overall, 1981 is expected to register growth of 0.8%, following a 1980 decline of 1.5%.

Risks to the Outlook

The only major sector whose role in recovery was not mentioned was the federal government. As for federal sending on goods and services, it seems clear that no matter who is President, spending will be kept fairly tight--that is, will not serve as the engine of recovery.

But what is not clear is government tax policy: Will there be a tax cut? If so, when? what kind? how much?

Given the political uncertainties surrounding such questions, a good assumption at this point seems to be that a tax cut will occur, under any President, but that at most it will be neutral--it will at most offset increases in Social Security taxes scheduled for next year and increases in taxes due to "bracket creep." In the short run, the net effect of such a tax cut on consumer demand would be small; and uncertainty about the form of the tax cut could delay investment decisions by business.

Another short-run effect would be a bigger federal deficit, and therefore a bigger borrowing requirement that will put upward pressure on interest rates. Which leads to the final federal question: What policy will the Federal Reserve Board follow?

Last October, the Fed let it be known that from then on it would be exercising tighter control over money growth. And even though interest rates subsequently skyrocketed, the Fed stuck to its guns. Moreover, the Fed chairman recently announced that money growth targets were being lowered. Given this evidence, plus numerous Fed statements promising not to backpedal on its October policy, it seems probable that when the

recovery spurs increased credit demands, interest rates will ascend to uncomfortable levels, partly choking off housing and auto demand.

Longer term, however, relatively tight Fed policy will cool the inflationary fires so that, perhaps by late 1981, the inflation premium on interest rates will have declined enough for rate increases to moderate.

In sum, the scenario foreseen here is that the recovery will be only modest due to rising interest rates and limited credit availability. Thus, even by 1981's fourth quarter real GNP is expected to be lower than in 1980's first quarter. The bright side of this scenario is that if the Fed maintains its policy, inflation will abate, setting the stage for solid growth in 1982.

If, by contrast, the Fed accommodates increased borrowing demands in the recovery, keeping interest rates down and demand up, it would kick off an inflationary spiral early in the recovery. Consumers, once more, would rush to buy, and in the process again get over their heads in debt. At the same time, inflation premiums would be getting built into interest rates, again putting strains on consumer liquidity. In short, economic volatility would persist, further feeding business and consumer uncertainty, thus further causing business and consumers to focus narrowly on short-term--at the expense of long-term--considerations.

Risks to the forecast presented at the end of this report, then, are: On the upside, the recovery could be stronger if the Fed yields to pressure to ease monetary policy. On the downside, inflation could be significantly worse than forecast by mid-1981. If inflation does take

off, housing could get hit by the end of next year as mortgage rates zoom; and business investment could be weaker as firms allocate funds to short-term profit maximization tactics in the face of an increasingly uncertain future.

Summary

Though the economy hurtled downward last quarter at a startling rate, the crash landing has yet to come. The recession, that is, still has some way to go, even though the economic news from now on will probably sound good in contrast to the news generated by the April-June period. More specifically, GNP in the third quarter is expected to decline at a 5.1% annual rate compared to the 9.1% debacle of the second quarter. By the fourth quarter of the year, the rate of economic decline is forecast to slow further to 0.5%.

Meanwhile, even as the economy continues to slide, increased house building will be spurring employment and income; and increased house buying (due to the fall in mortgage rates) will be spurring increased purchases of furniture and appliances. Following housing, the auto industry is expected to get a lift as consumers--who in recent months have been reducing debt loads--once again feel ready to buy on credit. And since they have not been much in the car market for a long time, they will want to replace the cars that should have been traded in last year.

Recovery, then, should be underway within six months. But even though 1981 is seen as a year of positive economic growth, the advance should be modest. Relatively tight monetary policy will likely lead early in the recovery to high interest rates, which in turn will shut off some demand for housing and autos. At the same time, federal

spending will not be doing a lot to fire up demand; and while a tax cut is expected, it does not now appear that it will be large enough to offset increases in taxes due to take effect in 1981.

The cheery side of the non-expansionary fiscal and monetary policies is that the inflation rate should moderate, thereby putting downward pressure on interest rates by late next year. Importantly, an improved inflation outlook would also help create the kind of stable environment needed for solid long-term economic growth.

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Department of Economics

NATIONAL PRODUCT ACCOUNTS AND KEY ECONOMIC INDICATORS
(Billions of Dollars)

	Actual	Forecast						Annual		
	1980	1980		1981						
National Product Accounts	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1979	1980	1981
Gross National Product	2523.4	2545	2596	2664	2751	2845	2937	2368.8	2546.3	2799.3
Consumer Spending	1628.2	1654	1687	1730	1789	1845	1889	1509.8	1649.7	1813.3
Gross Private Domestic Investment	366.9	353	362	375	393	415	445	387.2	367.4	407.0
Fixed Investment	355.2	352	360	371	386	400	420	369.0	362.6	394.3
Nonresidential	265.9	264	268	270	273	277	288	254.9	267.6	277.0
Residential	89.3	88	92	101	113	123	132	114.1	94.9	117.3
Inventory Change	11.7	1	2	4	7	15	25	18.2	4.9	12.8
Government Purchases	527.0	538	552	566	580	597	616	476.4	533.6	589.8
Federal	192.5	198	206	214	221	227	236	166.6	195.7	224.5
State & Local	334.5	340	346	352	359	370	380	309.8	337.9	365.3
Net Exports	1.3	0	-5	-7	-11	-12	-13	-4.6	-4.3	-10.8
Real GNP (1972 dollars)	1410.8	1392.6	1390.8	1396.8	1412.7	1429.2	1443.0	1431.6	1409.7	1420.4
(% change at annual rate)	-9.1	-5.1	-0.5	1.7	4.6	4.8	3.9	2.3	-1.5	0.8
Implicit Price Deflator (% change at annual rate)	10.4	9.0	8.8	8.7	9.0	9.2	9.3	8.8	9.2	9.0
Key Economic Indicators										
Unemployment Rate (percent)	7.5	8.5	8.9	9.0	8.7	8.2	7.9	5.8	7.8	8.5
Housing Starts (thousands of units)	1045	1225	1325	1450	1550	1625	1700	1745	1215	1581
Consumer Price Index (% change at annual rate)	13.6	10.2	8.9	9.2	10.0	10.1	10.1	11.2	13.7	9.9

8-28-80 C 5800-11 U

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August, 1980

U.S. BUSINESS OUTLOOK, SHORT-TERM

Executive Summary

Consumers downshifted their spending gears to super-low and business jammed on the investment brakes in 1980's second quarter. The result: Economic growth screeched to a halt and then lurched abruptly into reverse. Gross national product (GNP) in the April-June period plunged at an annual rate of 9.1%--as bad as the worst quarter of the severe 1973-75 recession. And final sales--GNP minus inventory change--plummeted by 9.6%, worse than any quarter of the last recession.

After dropping so far so fast, the economy subsequently will look good. Thus, it was an "encouraging" sign that the unemployment rate in July remained unchanged from June--at 7.8%.

Such news, however, appears good only through juxtaposition with second-quarter statistics, and should not obscure the fact that even after racing downhill at breakneck speed, the economy still has further down to go. Real GNP is forecast to fall at 5.1% and 0.5% annual rates in the third and fourth quarters, respectively.

The forces of recovery, however, are already gathering. Buoyed by substantial drops in mortgage rates and by declines in new-home prices, house buying has surged in recent months, and house building has started to come back. As housing demand recovers, so too will demand for the

big-ticket consumer durables that go into houses. But besides buying more washers and dryers, consumers are also expected to start buying more cars, even American-made cars. A prime driver of renewed auto demand will be improved liquidity positions of consumers: Since late last year, people have been reducing their debt burden (piled high during the 1979 spending spree) and they have been saving a greater portion of their incomes. As a consequence, the strain of paying off old debts plus interest is easing, and consumers will be seeking auto loans so they can replace the cars that should have been traded in months ago.

Once underway, the recovery is expected to progress at a modest pace. The economy is forecast to grow by only 0.8% in 1981; and by 1981's fourth quarter inflation-adjusted GNP is still expected to be slightly less than GNP in the first quarter of 1980. In other words, once recovery has begun, it should take about a year for the economy to get back to pre-recession levels of activity.

Key reasons for the slow recovery are that neither fiscal nor monetary policy are expected to be expansionary. Monetary policy, in particular, is assumed to stay relatively tight, so that rising interest rates early in the recession choke off some housing and auto demand.

Later in the recovery, however, this monetary policy would cool inflation, thereby reducing the inflation premium built into interest rates. In the event of moderating inflation and interest rates in late 1981, the stage would be set for solid growth in 1982 and beyond.